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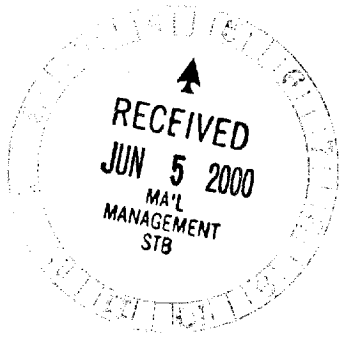


June 5, 2000

Via Hand Delivery

The Honorable Vernon A. Williams
Secretary
Office of the Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

ATTN: STB Ex Parte No. 582 (Sub-No.1)

Re: STB Ex Parte No. 582 (Sub-No.1); *Major Rail Consolidation Procedures*

Dear Secretary Williams:

Please find enclosed for filing in the above-referenced docket an executed original and twenty-five (25) copies of the Reply Comments filed on behalf of The Dow Chemical Company. An extra copy of this filing is enclosed for stamping and return to our office. Also enclosed is a diskette compatible to WordPerfect 7.0 with a copy of the Reply Comments.

Should you have any questions concerning this filing, please do not hesitate to contact the undersigned. Thank you for your cooperation and assistance in this matter.

Respectfully submitted,

Jeffrey O. Moreno

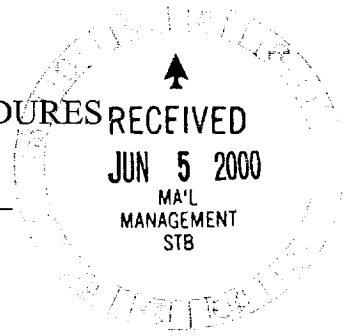
Enclosures

1920 N Street, N.W. Washington, D.C. 20036-1601 202-331-8800 fax 331-8330

BRUSSELS, BELGIUM CINCINNATI CLEVELAND COLUMBUS DAYTON PALM BEACH WASHINGTON, D.C.

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)
MAJOR RAIL CONSOLIDATION PROCEDURES



REPLY COMMENTS OF
THE DOW CHEMICAL COMPANY

The Dow Chemical Company ("Dow") hereby submits reply comments in response to the Advance Notice of Proposed Rulemaking ("ANPR"), served by the Surface Transportation Board ("STB" or "Board") in the above-captioned proceeding on March 31, 2000.

In its opening Comments, Dow expressed support for the pro-competitive actions addressed in the ANPR. Dow, however, contended that the proposals do not go far enough. They must be applied industry-wide, not just to merging carriers. In particular, Dow expressed concerns with the Board's past treatment of bottlenecks and the "one-lump" theory. Dow strongly believes that enhanced competition will resolve the Board's other concerns regarding service and safety. Any pro-competitive measures adopted by the STB, short of open access, however, will be substantially diluted if the Board does not also adopt simplified and expedited procedures for regulatory determinations, such as reasonable rates. Dow also urged the Board to more critically scrutinize claimed merger benefits and to protect shippers from acquisition premiums. Finally, Dow encouraged the Board to adopt expedited procedures for the resolution of loss and damage claims resulting from merger-related service failures.

Many commenters echoed the sentiments expressed by Dow. Some of those commenters proposed solutions that Dow desires to support. Other commenters, however, submitted proposals and expressed views contrary to those held by Dow. Through these reply comments, Dow summarizes and responds to various comments of other parties.

Dow also supports the Comments of the Alliance for Rail Competition ("ARC"). Dow's support is articulated more fully in the "Principles for Reform of Merger Proceedings and Related Regulation", which is attached to these Reply Comments as Exhibit 1.

I. The Board Should Promote Competition to the Maximum Extent Possible.

Many parties have proposed, and expressed support for, a variety of actions to enhance competition. Even the Class I railroads suggest some pro-competitive measures, despite their general resistance to enhancing competition overall. Dow supports competition to the fullest extent possible.

A. CMA Demonstrates That Competition Will Not Ruin the Rail Industry.

The Chemical Manufacturer's Association ("CMA"), of which Dow is a member, presented the most substantial pro-competitive proposal and argument in support of full competition, in the nature of open access. Dow endorses that proposal whole-heartedly.

CMA's comments are consistent with Dow's emphasis on competition as the best solution to service, rate, and safety issues. Most significantly, the Verified Statement of Robert E. McCormick presents a persuasive economic analysis of the effect of competition on the rail industry. Dr. McCormick convincingly demonstrates that competition and differential pricing are not anathema to one another. For example, many competitive industries, such as telecommunications and airlines, are deregulated and still are able to recover their sunk and fixed costs through revenue-based pricing. Yet, these

industries raised the same "chicken little" argument made by the Association of American Railroads ("AAR") in its comments that competition will destroy the industry. *See also* Comments of Norfolk Southern, pp. 39-50. Instead, competition has allowed those industries to flourish in previously unimaginable ways. The same could be true for the rail industry. *See also*, Comments of BASF Corporation, pp. 38-48.

Yet, the AAR and the Class I railroads persist in arguing that open access is re-regulation. If open access is re-regulation, then the telecommunications and electric industries also have undergone extensive re-regulation in recent years.

B. The Comments Reflect a Desire for at Least Some Competition Enhancing Measures.

Shippers made most of the proposals for enhanced competition. Although a few railroad commenters suggested some changes to preserve existing competition, they largely opposed any increases in competition.

To the extent the Board implements any of the pro-competitive proposals, the Class I railroads differ as to the proper scope. The Burlington Northern and Santa Fe Railway ("BNSF"), for example, insists that the Board must apply pro-competitive actions industry-wide, not just to merging carriers. (BNSF at 21, 25-26; CN at 29-30) The Union Pacific Railroad ("UP") and others take the opposite position. (UP at 10) Dow agrees with BNSF that any changes must be implemented industry-wide.

Virtually all of the chemical and plastic shippers, among a few others, echo Dow's support for implementing some version of the Canadian Interswitching and Competitive Line Rate provisions. (BASF at 6-7; Oxy at 9; Shell at 12-13) This would be an expedient and efficient way to enhance competition within an expanded radius around terminal areas. The availability of these provisions, both as a matter of law and economics, has enhanced the competitive options of Canadian shippers because they act as a constraining influence on non-competitive behavior.

Even the Class I railroads recognize the anti-competitive effects that a transcontinental merger could have with the closure of gateways. (NS at 35-39; UP at 11-12; BNSF at 22-23) As a result, they have proposed their own rules for keeping at least the major Mississippi River gateways open. This sudden awakening, however, is inconsistent with the Board's long held position, with railroad support, that the extension of bottlenecks is not anti-competitive. The potentially harmful effects described by the railroads are simply a magnification of the harmful effects that have occurred on a smaller scale in prior mergers. The cumulative anti-competitive effects of prior merger extensions of bottlenecks and closures of gateways are the very reason why the Board must take action to enhance competition today, not just preserve it.

Several of the Class I railroads also advocate preservation of the so-called "contract exception" to the rule that a shipper may not separately challenge a bottleneck rate. (BNSF at 26-27; UP at 11-12; CN at 31) They recognize that a vertical merger would eliminate the exception as a competitive option for shippers and propose that such shippers be permitted to use the exception after a merger, just as they could before the merger. Dow supports this proposal, but contends that it does not go far enough.

The Board clearly has recognized that the contract exception is a competitive benefit for shippers. A federal court, on appeal, has affirmed this conclusion. *Union Pacific R.R. Co. v. STB*, 202 F.3d 337, 342 (D.C. Cir. 2000). But, the "one-lump" theory refuses to recognize any loss of competition even where the contract exception applies. There is no rational basis for this discrepancy in the Board's holdings. Moreover, it illustrates that there is and has been a loss of competition in prior merger proceedings when the Board refused to impose conditions to protect bottleneck shippers from competitive harm.

Dow has asked the Board to abandon the one-lump theory altogether. At the very least, however, Dow would support those commenters who would preserve the one-lump

theory but shift the burden of proving its applicability to the merging rail carriers. (EEI at 4-5; IMPACT at 25-26)

Furthermore, Dow supports those commenters who ask the Board to err on the side of increasing competition when evaluating requests for conditions. (IMPACTat 27-29) In past merger proceedings, the Board has denied conditions simply because they would leave a shipper in a better competitive position than it was pre-merger. Although that observation was accurate, there often was no feasible lesser condition that would protect the shipper. As a result, the shipper was denied any protection. In these situations, the Board must err on the side of creating, not reducing, competition.

II. Commenters Generally Support STB Action to Address Service Disruptions and Remedies.

The proposals to address merger-related service disruptions and remedies are as varied as the commenters. Nevertheless, several general themes predominate the comments.

Virtually all parties suggest that the Board require merger applicants to submit a "Service Implementation Plan", or similar plan, explaining the steps that will be taken to protect shippers against merger-related service disruptions. (NS at 19; UP at 8; BNSF at 17; CSX at 13-17; DOT at 7-8; CN at 12-13; CMA at 19) Some of those commenters propose an additional element that would require applicants to show that they will have adequate infrastructure or will make infrastructure investments. (BNSF at 20; NS at 24) Dow supports both of these concepts.

Many commenters also ask the Board to require merger applicants to provide different, or more detailed, service reporting requirements. (DOT at 6-7; SPI at 13) Dow agrees that the service measures the Board currently requires are not very helpful or relevant for individual shippers. The Board should seek comments regarding the service measures that are most important to shippers. Merger applicants should provide the

proper measures for at least a year prior to the merger and throughout the merger oversight period.

Some commenters, both shippers and railroads, suggest that the Board should impose specific minimum service standards upon merging carriers. Dow opposes these suggestions. The Board should not become involved in rail service at this level of detail. At best, the Board would have to limit itself to very general standards that would apply across the industry, but have only minor relevance to individual shippers. At worst, the Board would become entwined in a morass of service standards for a seemingly infinite number of situations. There also is a risk that those standards would become the *de facto* measure for determining if a shipper is entitled to damages for poor service. Such results would not be in the public interest.

The UP proposes regulations to address both service remedies and damages. (UP at 9) Dow contends that the UP proposal is worse than existing regulations. In order to be eligible for either monetary or service relief under the UP proposal, a shipper would have to prove that a carrier's service measurement had deteriorated by an average of more than 50% from the pre-merger base period for 120 consecutive days. It is questionable whether the UP service crisis, at its depth, ever would have satisfied this standard. Moreover, UP's proposed service remedy is essentially the same remedy the Board already provides in its emergency service rules. The monetary remedy is limited to "incremental transportation costs that could not reasonably be mitigated." Since incremental transportation costs usually are a mitigation measure, it is unclear what UP means by this statement. Also, since some commodities cannot be transported safely or economically, except by rail, those shippers would be denied any remedy under UP's proposal. Furthermore, most of the damages sustained by shippers in the UP and Conrail service crises extend well beyond incremental transportation costs.

NS contends that the STB already has adequate emergency service standards. (NS at 21) Dow does not agree. The Board should add an additional element of relief.

During service emergencies, the Board should allow a shipper to short-haul the troubled rail carrier. This will allow traffic to be diverted off of an overburdened rail system earlier, and it will not burden the system with the trackage rights operations of a second carrier, for which NS has expressed concern. (NS at 23) There is not sufficient incentive for the troubled carrier to short-haul itself, as Dow discovered when it asked the UP to short-haul itself during its service crisis.

Throughout their comments, the Class I carriers characterize damage claims for service failures as "penalties." (CSX at 18; NS at 21) Nothing could be further from the truth. Through damage claims, shippers are seeking compensation and restitution for expenses caused by service failures. This difference in terminology graphically illustrates the different perspective that railroads have about customer service compared with competitive industries. Even more graphic is NS' comment that railroads should not be guarantors of service levels. That comment would never be contemplated in any competitive industry. If not the service provider, who is the guarantor?

Dow does agree, however, with NS' comment that the market is the best guarantor of service. (NS at 21) But, Dow does not agree that the market is allowed to play this role in the rail industry. In a truly competitive market, the risks associated with service failures would fall upon the individual competitor (*e.g.,* the railroad), not the customer.

Despite its disagreements with the railroads, Dow does agree that the Board should not involve itself in resolving damage claims or even in formulating standards for the recovery of those claims. Moreover, as Dow explained in its opening comments, there may be statutory prohibitions against the Board inserting itself into such claims. Dow, however, does believe that the Board can and should establish procedures for the expedited resolution of service-related damage claims through arbitration. This would enable shippers to enjoy the benefits of existing standards for recovery of damage claims without the otherwise prohibitive costs and time delays.

III. The Board's Analysis of Merger Benefits Should Ensure that Shippers are Insulated from the Effects of Acquisition Premiums.

Most commenters agree that the Board should more thoroughly scrutinize merger benefit claims and require merger applicants to support their claims with greater detail. While Dow supports those proposals, its primary concern is that the Board protect shippers from the consequences of unrealized merger benefits. The National Grain and Feed Association, Pennsylvania Power & Light, and the National Industrial Transportation League expressed the same concerns.

The determination of merger benefits is extremely imprecise and subject to multiple variables in the future. NS articulated this problem particularly well at page 13 of its comments:

> Estimates of merger-related public benefits necessarily involve predictions about the future effects of an often complex transaction that, by definition, has yet to be implemented. Moreover, both as a general matter and in the actual implementation of major consolidation transactions, railroads do not function in a static environment, but are affected – often in significant and unanticipated ways – by dynamic business and market conditions unrelated to a particular merger transaction. For this reason, no railroad merger applicant can possibly guarantee that the merger synergies and benefits it expects to achieve from a proposed rail consolidation will be achieved in precisely the same manner, to the same extent and under the same anticipated timing as described in the railroad consolidation application.

This uncertainty renders any assessment by the Board tenuous at best.

Therefore, the Board must reverse its treatment of acquisition premiums and refuse to allow such premiums to affect the jurisdictional threshold and revenue adequacy determinations. Only then will captive shippers not be exposed to the risk that their rates will increase if the merger benefits fall short of projections.

In essence, Dow is urging the Board to get out of the business of calculating merger benefits. Although the Board must evaluate merger benefits as part of its public

interest determination, it need not be concerned with the mathematical precision that is required to ensure that the benefits exceed an acquisition premium. Instead, the burden will fall upon the applicants to protect shippers if the benefits prove to have been overstated. This also will deter carriers from inflating their benefit projections.

IV. The STB Must Make Regulatory Protections Available to All Shippers on an Efficient and Expedited Basis.

Several commenters advocate arbitration or mediation of various disputes. Most of their proposals are consistent with Dow's proposal that the Board implement simpler and expedited procedures for the resolution of rate reasonableness claims, service disputes, and other regulatory remedies. Shippers cannot reap the full benefits of enhanced competitive measures if the relief is only obtainable through expensive and lengthy proceedings. Dow urges the Board to establish procedures for expedited (*e.g.,* 90 days) binding arbitration of disputes.

Rate reasonableness disputes are costly and time consuming to pursue. Low volume shippers, or even high volume shippers who split their traffic over multiple traffic lanes, often cannot justify the time and expense to pursue a claim. Other regulatory remedies, both current and proposed, also are costly and time consuming. Similarly, it is costly and time-consuming to pursue service-related damage claims. As a consequence, most regulatory protections and remedies are not readily available to most shippers. Rail carriers know this and use it to their advantage. Thus, many shippers are as captive today as they would be without any regulation.

Dow's concern is shared by ARC. Like ARC, Dow supports efforts to provide captive shippers with a realistic means of obtaining regulatory relief. Dow agrees with ARC that a final arbitration system, similar to that used in Canada, could provide an efficient and cost-effective alternative to the costly and lengthy regulatory proceedings that are standard today.

Arbitration procedures for the resolution of merger-related service disputes and damage claims also are important. These procedures would be at the option of the shipper and binding on the carrier. CSX actually proposes a similar arrangement, but for non-binding mediation rather than binding arbitration. (CSX at 20) Unless it is binding, however, the CSX proposal only injects an additional layer of time and expense into the dispute resolution process. UP also agrees that the Board has the authority to establish expedited procedures to resolve service disputes. (UP at 6) Several other commenters also propose arbitration of service disputes. (DOT at 10)

Unlike some other commenters, however, Dow does not believe the Board can or should resolve disputes over service-related damage claims. Rather, it should set up an alternative dispute process that can be used by the shipper, if it so chooses.

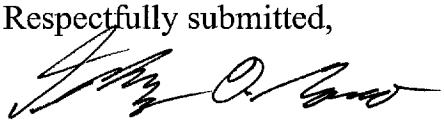
V. Conclusion

Dow urges the Board to initiate the following changes to its merger rules and policies:

- Allow competition to govern rates, safety, and service through an open access system, like that proposed by CMA.
- Prevent the extension of bottlenecks by preserving gateways, both physically and economically.
- Abandon the "one-lump" theory.
- Preserve the "contract exception" in end-to-end mergers.
- Reverse the Bottleneck Decisions.
- Adopt Canadian style terminal access provisions, such as Interswitching and Competitive Line Rates.
- Protect shippers from the potential adverse effects of acquisition premiums by excluding the premium from the jurisdictional threshold and revenue-adequacy determinations.
- Abandon the "monopoly abuse" test for reciprocal switching.

- Establish rail service reporting requirements that are meaningful to individual shippers.
- Require merger applicants to submit "Service Implementation Plans."
- Require carriers to short-haul themselves during service emergencies.
- Require carriers to participate in binding arbitration of merger-related damage claims, if the shipper chooses arbitration. But, the Board should not adopt standards for recovery or review the decisions of an arbitrator.
- Adopt a Canadian style final arbitration system for obtaining regulatory relief.

Respectfully submitted,



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June 5, 2000

Exhibit 1

PRINCIPLES FOR REFORM OF MERGER PROCEEDINGS AND RELATED REGULATION

Upon review of the statements filed in Ex Parte No. 582 (Sub-No. 1), many members of the rail customer community recognize our growing consensus on issues raised by the concentration of railroad market power in the U.S. and the danger of the emergence of two huge monopoly railroads in North America. Our consensus is reflected in the following pro-competitive principles, which should guide the Surface Transportation Board in its development of improved policies and procedures:

- Stronger action must be taken to hold merging railroads accountable for their promises of improved service and more efficient operations.
- The severe service problems that have resulted from past railroad mergers must be prevented and/or mitigated through effective remedies, including performance guarantees, compensation and access to other railroads.
- Current regulatory policies, including the bottleneck decision, the "one-lump" theory, and the "2-to-1" rule, have failed to prevent the reduction of competition among major railroads, which now enjoy unprecedented market power.
- The regulatory policies of the past, which the STB has recognized as inadequate and which even many railroads are now recognizing as flawed, should be replaced by new policies aimed at promoting competition.
- Access remedies such as trackage rights and switching on fair and economic terms should be more readily available, whether or not there are future mergers.
- Contractual and operational barriers to competition from smaller railroads should be eliminated or reduced, whether or not there are future mergers.
- Gateways for all major routings should remain open on reasonable terms.
- Adverse impacts of rail consolidations on the safety of rail operations and on the interests of rail labor should be mitigated.
- Cross-border mergers should not interfere with effective regulation and the enhancement of competition; and
- Railroad mergers can no longer be considered in isolation.

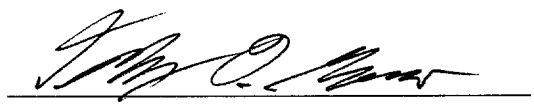
The need for improved and enhanced competition along these lines is so strong and immediate that the STB should use the full extent of its authority to revise its policies consistent with these principles. The Board's efforts in Ex Parte No. 582 (Sub-No. 1) should include, but not be limited to, all of the recommendations in the proceeding that would:

1. Increase competition among railroads;
2. Improve service and safety; and
3. Address any problems or flaws—present or future—that result directly or indirectly from rail mergers.

Recognizing that the Board may not have the necessary authority to fully achieve comprehensive policy reform consistent with all of the above-listed principles, the rail customer community will continue to press for congressional action that would provide the necessary legislative direction to achieve these principles.

Certificate of Service

I certify that I have this 5th day of June 2000, served copies of the "Reply Comments of The Dow Chemical Company" upon all parties of record in this proceeding, by First Class mail.



Jeffrey O. Moreno